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IN THE

Supreme Court of the United States

October Term, 1986

CAMPBELL SALES COMPANY,
Petitioner,

against

NEW YORK STATE TAX COMMISSION,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK

RESPONDENT'S BRIEF IN OPPOSITION

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Dated: January 20, 1987

Questions Presented.

1. Whether New York's taxation of the combined allocated income of corporation engaged in a unitary business, where one or more of these corporations in the combined group is a resident of and does business in the State, violates due process clause of the Fourteenth Amendment of the United States Constitution.

2. Whether Public Law 86-272 (15 USC § 381) limits the power of a state to tax the properly allocated income of corporations, on a combined basis, which are engaged in a unitary business.

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ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK.

RESPONDENT'S BRIEF IN OPPOSITION

The New York State Tax Commission respectfully requests that this Court deny the petition for writ of certiorari, seeking review of the opinion and decision in this case of the Court of Appeals of the State of New York. The opinion and decision are reported at 68 NY2d 617 and 68 NY2d 808.

Statement of Facts

New York State imposes a franchise tax on corporations for "the privilege of exercising its corporate franchise, or of doing business, or of employing capital, or of maintaining an office in this state * * *". New York Tax Law Article 9-A, § 209(1), as amended by New York Laws of 1969, chapter 1072. The petitioner, Campbell Sales Company (Sales) has been doing business in New York State since 1941 (F-3)[1].

New York Tax Law § 211(4) authorizes the New York State Tax Commission to permit or require a New York taxpayer, where substantially all[2] of the capital stock is owned or controlled by another corporation, to file tax returns on a combined basis with other corporations in the owned or controlled group where the Commission deems such a report necessary because of intercompany transactions[3] in order properly to reflect tax liability under New York Tax Law, Article 9-A. In the report, the combined entire net income of the corporations in the group, allocated to New York, is reported and is the base on which tax liability is computed.

The Tax Commission's Regulations provide that in order to permit or require the filing of franchise tax returns on a combined basis, the corporations in the combined group must be in substance parts of a unitary

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[1]References are made to pages of petitioner's appendix.

[2]*Substantially all* under the Tax Commission's Regulations means 80% or more 20 NYCRR 6-2.2(3)(b).

[3]Under the Tax Commission's Regulations, there must be substantial intercompany transactions, which requirement is met if 50% or more of a corporation's receipts are from qualified activities. It is not necessary that the intercompany transactions be between any one member of the group with every other member but must be among all members of the combined group. 20 NYCRR 6-2.3(c).

business[4] conducted by the entire group of corporations. 20 NYCRR 6-2.3(1).

As found by the Tax Commission, Campbell Soup Company (Soup), a New Jersey corporation, is a manufacturer and processor of food and food products. It is the parent and 100% owner of subsidiary corporations which include not only the petitioner but also Campbell Frozen Food Distributing Co., Southeastern Wisconsin Products Company, Valley Tomato Products, Inc., Campbell Soup (Sumter Plant), Inc., Joseph Campbell Company, Champion Valley Farms, Inc., Campbell's Soup Inter-America, Inc., and Campbell's Export Sales, Inc., the companies found by the State Tax Commission to be engaged in a unitary business (F-8, F-9).

Prior to the tax period here at issue, Campbell Frozen Foods Distributing Co. filed New York franchise tax returns on a separate basis. It buys all of its frozen dinners from Soup and sells them to institutions. Southeastern Wisconsin Products Co. sells all of its products, food and flavorings, to Soup. Valley Tomato Products, Inc. manufactures tomato paste and sells all of it to Soup. Campbell Soup Co. (Sumter Plant) Inc. manufactures frozen dinners and processes poultry. Approximately 70% of its sales are to Soup and the remainder are to retailers. Joseph Campbell Co. purchases and grows vegetables. All of its products are sold to Soup. Champion Valley Farms produces pet foods. It sells all of its products to Soup. Campbell Soup Inter-America, Inc. is a western

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[4]New York is not considered to be a unitary tax state since it has never, except in the case of oil companies, required or permitted alien corporations, corporations organized under the laws of a country other than the United States which has income from sources outside the United States, to be included in a combined return. 20 NYCRR 6-2.5(b) and 3-8.3.

hemisphere trading company which sells Soup's products in Puerto Rico. Campbell's Export Sales, Inc., is a commission DISC[5] which sells Soup's products outside of the United States (F-8, F-9).

Sales, a New Jersey corporation has its principal office in Camden, New Jersey, and maintains 40 offices in 34 states, including two offices in New York. Since its organization in 1922, the petitioner has been engaged in the business of acting as sales representative or broker in the food business, soliciting orders for the products of Soup and Soup's affiliates. Sales does not represent other food manufacturers. In Alaska and Hawaii, Sales retains food brokers to solicit order for Soup's products. The petitioner, from time to time, also uses outside brokers to solicit orders for new products of Soup and its subsidiaries (F-3).

Sales is compensated by Soup for acting as its sales representative or broker under an agreement dated 1947. The agreement provides for payment of the petitioner's costs plus an additional payment of 4% of those costs. Expressed as a percentage of Soup's sales, the payments varied between 2.0921% and 2.7520% of the amount of Soup's sales between 1954 and 1977. The payments are a fair and reasonable commission and were not less and were probably more than would be paid for such work on an arm's length basis involving unrelated parties (F-3, F-4).

The total amounts paid by Soup to Sales as a percentage of Soup's sales everywhere and the amounts paid in respect of New York sales as a percentage of New York sales for the years 1974 through 1977 were as follows:

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[5]Domestic international sales corporations (DISCs) receive special tax treatment under federal and state law. See, *Mtr. of Westinghouse Electric Corp. v. Tully*, 466 U.S. 388 (1984).

Year	Compensation as a Percentage of Total Sales of Soup	N.Y. Compensation as a Percentage of N.Y. Sales
1974	2.4165%	2.7601%
1975	2.4735	3.0176
1976	2.4851	2.7978
1977	2.5112	2.7356 (F-5, F-6)

Since 1941, Sales has calculated its New York franchise tax liability pursuant to a formula agreed upon (modified in 1947) by it, Soup and the Tax Commission, under the provisions of New York Tax Law § 211(5). For purposes of the agreement, Soup computes its gross income as 4 percent (adjusted in the event Soup's advertising expenses fall below 3½ percent of its sales) of Soup's total sales for the year, subtracts its expenses, and allocates the net income to New York in the proportion which petitioner's expenses incurred with relation to New York bear to petitioner's total expenses. Petitioner's computation of its tax liability for the fiscal year at issue was $170,654 (F-6).

For the fiscal years 1970 through 1977, the tax which would have been computed under the statutory formula and the tax computed and paid by petitioner pursuant to the 1941 agreement, as modified, in 1947, were as follows:

FYE	TAX PER STATUTORY FORMULA	TAX PER AGREEMENT
08/02/70	$ 6,408	$ 71,207
08/01/71	8,196	86,473
07/30/72	13,714	97,498
07/29/73	10,316	116,892
07/28/74	11,348	230,564
08/03/75	16,204	159,819
08/01/76	16,620	212,051
07/31/77	9,463	199,772 (F-7)

During the fiscal year under review, the petitioner had approximately 1,000 employees. Orders which the petitioner solicits for Soup are transmitted to Soup's offices in Camden, New Jersey, for acceptance and credit approval. The goods are then shipped directly from one of Soup's plants to the wholesaler or distributor, and payment for them is made directly to Soup (F-3).

Sales pays its own expenses (wages, salaries, rentals, etc.), most of which are to unrelated parties, and is reimbursed for them by Soup. Sales' president, who works full time for it, holds the office of vice-president in Soup. From time to time, employees of Soup's marketing office accompany Sales' employees on their routes to ascertain whether a particular product is selling well and to gather information for promotional materials. Some of Sales' administrative functions, including the accounting and legal functions, are performed by Soup. Sales maintains its own books of account and bank accounts (F-4, F-5).

The sales of Soup and the amounts and percentages thereof made to New York customers for the years 1974 through 1977 were as follows:

Year	Total Sales	Sales to N.Y. Customers	N.Y. Sales as Percent of Total Sales
1974	$1,229,936,937	$ 99,487,906	8.0889
1975	1,240,256,044	95,948,894	7.7362
1976	1,307,918,713	94,237,765	7.2052
1977	1,426,203,583	110,845,606	7.7721 (F-5)

Petitioner's operating expenses and the portion thereof actually incurred with respect to New York for the years 1974 through 1977 were as follows:

Year	Total Expenses	Expenses Related to N.Y.	N.Y. Expenses as Percent of Total Expenses
1974	$26,376,484	$2,500,974	9.4818
1975	27,152,042	2,783,962	10.2532
1976	29,102,837	2,676,431	9.1963
1977	32,605,526	2,915,653	8.9422 (F-5)

A notice of deficiency was issued by the respondent to Sales for additional franchise tax due under Article 9-A of the Tax Law for the fiscal year in issue in the amount of $544,626.00, plus interest thereon (F-2).

The deficiency resulted from computing Sales' tax liability on its entire income combined with that of Soup and its subsidiaries previously named, allocated to New York.[6]

The New York entire income of corporations doing business within and without the State, either singly or combined with a group of corporations which conduct a unitary business, is allocated to the State under a three factor formula.[7] The factors used in the formula are property, payroll and receipts within and without the State to arrive at their New York business allocation percentage. The factors within the State are divided by the factors from sources everywhere. The receipts percentage is used twice, or given double weight, in the formula. The resulting percentages are then added together and divided by the number of the percentages to determine the business allocation percentage. Receipts within the State

[6]The asserted deficiency was reduced by a credit in the amount of $6,144.00 to which Campbell Foods Distributing Corp. was entitled.

[7]Where allocated entire net income of a group of corporations is combined, intercorporate dividends, stockholdings and indebtedness are eliminated.

from the sales or sale of taxable personal property means sales of the property which is shipped to points within the State. New York Tax Law § 210(3)(a)(1), (2), (3), and (4).

Sales reported the combined group's payroll, property and receipts factors within and without New York to be as follows:

	Payroll	Property	Receipts
New York	1,732,308	970,625	112,094,752
Everywhere	243,553,301	510,202,923	1,457,307,191
New York %	.7113	.1902	7.6919

Reasons Why The Petition Should Be Denied

1. New York taxation of the combined income of corporation engaged in a unitary business which is properly allocated to the State does not violate the due process clause of the United States Constitution.

In structuring its corporate franchise tax, New York seeks to place business entities that conduct a unitary business through multiple corporations on the same footing as business entities that conduct their affairs through a single corporation to reflect properly their tax liability. If a corporation is truly separate, New York treats it separately for tax purposes even if it shares a common ownership with other corporations.

Petitioner, the Campbell Sales Corporation, maintains two offices in New York and has paid New York franchise taxes for over 30 years. It is a wholly owned subsidiary for the Campbell Soup Company, a New Jersey corporation. Following an audit, the New York Tax Commission determined that viewing petitioner in isolation did not pro-

vide an accurate basis for calculating the franchise taxes due New York. Applying New York law, the New York Court of Appeals held that in view of the fact that petitioner was part of a unitary group consisting of Campbell Soup and its various subsidiaries, it was impossible to determine petitioner's true income without computing its tax liability on a combined basis. Petitioner recognizes that this determination is not an appropriate subject for review in this Court (*see* Pet. at 15). The tax liability imposed on petitioner is the same as the tax it would have been required to pay had it been a division of Campbell Soup. Nevertheless, it urges that the tax imposed violates its due process rights. Because the decision of the New York Court of Appeals is based on an application of New York law and did not involve a question of federal law, the petition for a writ of certiorari should be denied. *See* Sup Ct. R. 17.1.

Moreover, there is no constitutional prohibition which prevents States from requiring corporations to file combined reports with foreign or alien corporations which are engaged in a unitary business in which their companies' income is subject to a tax on an apportioned basis. The fact that income of corporations which do not do business in a taxing State is combined with that of the taxed corporation is irrelevant. *Container Corporation of America v. Franchise Tax Board,* 463 U.S. 159 (1983); *Mobil Oil Corp. v. Commissioner of Taxes,* 445 U.S. 425, 440, 441 (1980). It is settled beyond question that the "entire net income of a corporation, generated by interstate as well as intrastate activities, may be fairly apportioned among the States for tax purposes by formulas utilizing in-state aspects of interstate affairs." *Northwestern State Portland Cement Co. v. Minnesota,* 358 U.S. 450, 460 (1959); *General Motors Corp. v. Washington,* 377 U.S. 436 (1964); *Mobil Oil Corp. v. Commissioner of Taxes,*

445 U.S. 425, 436-442 [*supra*]. See also, *Underwood Typewriter Co. v. Chamberlain,* 254 U.S. 113 (1920); *Hans Rees' Sons v. North Carolina,* 283 U.S. 123 (1931); *Butlers Brothers v. McColgan,* 315 U.S. 501 (1942); *Moorman Manufacturing Co. v. Bair,* 437 U.S. 267 (1978). In determining what constitutes "fairly apportioned", this Court has declared "That the apportionment may not result in mathematical exactitude is certainly not a constitutional defect. Rough approximation rather than precision is, as a practical matter, the norm in any such tax system." *Illinois Central Railroad Co. v. State of Minnesota,* 309 U.S. 157, 161 (1940), reh den, 309 U.S. 695 (1940). In *Mobil Oil Corp., supra,* 445 U.S. at 439, this Court observed that "the linchpin of apportionability in the field of state income taxation is the unitary-business principle" (footnote omitted). In accordance with this principle, the Court has upheld state apportionment formulas, which combine the income of several related corporations engaged in a "unitary" business. Income is generally allocated to the taxing State by multiplying the total net income of the enterprise by a percentage comprised of the average of the ratios of in-state property, payroll, and receipts to total property, payroll and receipts. See, *United States Steel Corp. v. Multistate Tax Commission,* 434 U.S. 452, 475 n 25 (1978); *Exxon Corp. v. Wisconsin Department of Revenue,* 447 U.S. 207, 214 n 3 (1980); *Mobil Oil Corp., supra,* 445 U.S. at 429-430 nn 2-4. A unitary business is one in which all of the corporate constituents are involved in an economically functionally-related enterprise. As one leading commentator has observed, the "very essence of formulary apportionment [is] that where there are integrated, interdependent steps in the economic process carried on by a business enterprise, there is no logical or viable method for accurately separating out the profit attributable to one step in the economic process from other steps." J. Hellerstein, *State*

and Local Taxation, 400 (3d ed, 1969). See also, *Butler Brothers, supra,* 315 U.S. at 508; *Hans Rees' Sons, supra,* 283 US at 133.

Sales' petition for certiorari focuses on the fact that the respondent made a finding that the commissions paid by Soup to the petitioner were fair and reasonable and were probably more than would be paid to it on an arm's length basis. The petitioner's argument based on this finding ignores the economic reality that income of unitary business earned in New York is not derived only from the profits received from sales solicitation, but, is also derived from the mark-up of goods sold and delivered to New York customers.

As was pointed out below in the opinion of Justice Yesawich that the Court of Appeals adopted (D-8 - D-9, C-1), petitioner's willingness to pay conspicuously greater taxes for many years than it would have paid as a separate company implicitly acknowledged that its franchise tax on a separate basis would have been distorted. Moreover, petitioner does not seek review of the determination of the New York Court of Appeals that it was impossible to compute the tax owed by petitioner except on a combined basis.

The three factor formula, where the factors are equally weighted, is the standard and generally accepted formula for allocating income. However, the Constitution imposes no single allocation formula on the States. *General Motors v. District of Columbia,* 380 U.S. 553 (1965); *Wisconsin v. J. C. Penney Co.,* 311 U.S. 435, 445 (1940). New York's statute providing that the situs of sales of tangible personal property is to be determined by the place where the property is shipped is similar to the provisions of the New Jersey tax law. New Jersey, the State where Soup accepts

orders for property obtained by Sales and the State from which a large percentage of the property is shipped, also has similar provisions for determining the situs of the sale of property. New Jersey Statutes Annotated 54:10A-6(B).

Forty-five States and the District of Columbia include the receipts factor in their allocation formulae in apportioning income of businesses to their States for tax purposes. Of these, only two, Arizona and Vermont, do not determine the situs of receipts by the place of delivery of tangible personal property. As a result, if New York were not permitted to tax income derived from the sale of property shipped to New York, the income would not be taxed in any State.

The double weighting of the receipts factor is a two edged sword—it reduces the taxable income of some taxpayers while increasing it for others. A survey taken of eight industry groups: (1) agriculture, forestry and fisheries, (2) mining, (3) construction, (4) manufacturing, (5) wholesale trade, (6) retail trade, (7) fiscal (except banks) and (8) services was undertaken by New York. Transportation was not included in the study, since it is taxed under separate provision in New York for which double weighting does not apply. Only two industry groups showed a net increase in tax—agriculture, forestry and fisheries up 1.7 percent and construction up 1.2 percent, while all industries showed a net decrease. The net effect of all groups together was a 5.5 percent decrease in revenue received by New York. The effect of double weighted receipts for years, not studied, is a matter of conjecture. *Use of Weighted Sales Factor in Apportioning Corporate Income* by Ralph Vecchio, Deputy Director, Corporation Tax Bureau, Department of Taxation and Finance, New York, *Report of Proceedings of the Forty-Fourth Annual Meeting of the National Association of Tax Administrators,* p 78.

Sales has not demonstrated that under the New York formula, as applied to the combined group, the income attributed to New York is out of all proportion to the business transacted in the State by the unitary business or has led to a grossly distorted result. *Norfolk & Western R. Co. v. State Tax Comm.*, 390 U.S. 317, 326 (1968); *Hans Rees' Sons, Inc. v. North Carolina* 283 U.S. at 274, *supra*. The facts show the contrary.

The combined entire net income of the group expressed as a percentage of their combined receipts of $1,457,307,191 is 10.4815%. New York receipts of the group are $112,094,752. Applying 10.4815% to New York receipts results in income of $11,749,211 or 7.6919% of $152,747,499, the entire net income of the group. However, under New York's allocation formula, *see* pp. 9-10, *supra,* the New York entire net income of the combined group is $6,128,807 by applying the New York business allocation percentage of 4.0713%.[8]

2. Public Law 86-272 (15 USC § 381) does not limit the power of a state to tax the combined and properly allocated net income of corporations which are engaged in a unitary business.

Congress, in limiting the power to tax the net income derived within the State by Public Law 86-272, specified the limitations under which the curtailment of State power is to apply. The limitation applies where the business activities within a State consist only of the solicitation of orders for sales, and where the solicitation is made by independent contractors.

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[8]Sales' New York tax would be reduced by 29.6416% to $4,375,452 if the receipts factor in the allocation formula was singly weighted instead of double weighted.

Sales is not an independent contractor. It solicits orders only for Soup. Sales is licensed to do business in New York and does business in New York other than soliciting sales for Soup. During the year in issue it operated two business offices, engaged sales people in New York and incurred business expense of nearly $3 million. Sales is a foreign corporation authorized to do business in New York and, as such, is a resident of the State. *St. Louis, B & M Ry. v. Taylor,* 266 U.S. 200, 207 (1924); New York CPLR 503(c); *Kochany v. Chrysler Corp.*, 67 NY AD2d 637 (1979).

The limitation on the power of a State to tax by Public Law 86-272 does not apply where a corporation is, as here, a resident of the taxing state. The tax here is imposed only on Sales.

The history of Public Law 86-272 does not show that Congress intended to prevent a State from taxing a corporation subject to its jurisdiction on properly allocated income combined with other corporations where the corporations are engaged in a unitary business. Congress had a limited purpose in enacting the statute as discussed in S. Rep No. 658, 86th Cong., 1st Sess. and H.R. Rep. No. 926, 86th Cong., 1st Sess. It was not enacted to prevent taxation of allocated income of corporations engaged in a unitary business where the activities of the business included the actual doing of business or residence in the taxing State. The House Report 936, p 3, states:

> "In terms of case law, this bill would not affect fact situations such as those in the Northwestern and Stockham cases.* In both of those cases the out-of-State business maintained an office in the

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**Northwestern State Portland Cement Co. v. Minnesota* and *Williams v. Stockham Valves & Fillings, Inc.*, 358 U.S. 450 (1959).

market State and under the standard of this bill they would remain subject to taxation."

See Hubelin, Inc. v. South Carolina Tax Commission, 409 U.S. 275 (1972). New York's taxing policy does not contravene that purpose. *See Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947); *accord*, e.g., *Ray v. Atlantic Richfield Co.*, 435 U.S. 151, 157 (1978).

CONCLUSION

For these reasons, the petition for a writ of certiorari should be denied.

Dated: Albany, New York
January 20, 1987

Respectfully submitted,

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APPENDIX

Statutes and Regulations Involved

New York Tax Law § 209 provides in relevant part:

> "§209. Imposition of tax; exemptions
>
> "1. For the privilege of exercising its corporate franchise, or of doing business, or of employing capital, or of owning or leasing property in this state in a corporate or organized capacity, or of maintaining an office in this state, for all or any part of each of its fiscal or calendar years, every domestic or foreign corporation, except corporations specified in subdivision four of this section, shall annually pay a franchise tax, upon the basis of its entire net income, or upon such other basis as may be applicable * * *."

New York Tax Law § 210 provides in relevant part:

> "§ 210. Computation of Tax
>
> "1. The tax imposed by subdivision one of section two hundred nine of this chapter shall be, in the case of each taxpayer:
>
> "(a) a tax (1) computed at the rate of ten per centum on its entire net income, or the portion thereof allocated within the state as hereinafter provided,
>
> * * *

"3. The portion of the entire net income of a taxpayer to be allocated within the state shall be determined as follows:

"(a) multiply its business income by a business allocation percentage to be determined by

"(1) ascertaining the percentage which the average value of the taxpayer's real and tangible personal property within the state during the period covered by its report bears to the average value of all the taxpayer's real and tangible personal property wherever situated during such period;

"(2) ascertaining the percentage which the receipts of the taxpayer, computed on the cash or accrual basis according to the method of accounting used in the computation of its entire net income, arising during such period from

"(A) sales of its tangible personal property where shipments are made to points within this state,

"(B) services performed within the state, provided, however, that in the case of a taxpayer engaged in the business of publishing newspapers or periodicals, receipts arising from sales of advertising contained in such newspapers and periodicals shall be attributable only to the extent that such newspapers and periodicals are delivered to points within the state.

"(C) rentals from property situated, and royalties from the use of patents or copyrights, within the state, and receipts from the sales of rights for

closed-circuit and cable television transmissions of an event (other than events occurring on a regularly scheduled basis) taking place within the state as a result of the rendition of services by employees of the corporation, as athletes, entertainers or performing artists, but only to the extent that such receipts are attributable to such transmissions received or exhibited within the state and

"(D) all other business receipts earned within the state, bear to the total amount of the taxpayer's receipts, similarly computed, arising during such period from all sales of its tangible personal property, services, rentals, royalties, receipts from the sales of rights for closed-circuit and cable television transmissions and all other business transactions, whether within or without the state;

"(3) ascertaining the percentage of the total wages, salaries and other personal service compensation, similarly computed, during such period of employees within the state, except general executive officers, to the total wages, salaries and other personal service compensation, similarly computed, during such period of all the taxpayer's employees within and without the state, except general executive officers; and

"(4) adding together the percentages so determined and dividing the result by the number of percentages; provided, however, for taxable years beginning on or after the first day of January, nineteen hundred seventy-six, the business allocation percentage shall be determined by adding the percentages so determined and an additional percentage equal to the percentage determined under sub-

paragraph two of this paragraph together, and dividing the result by the number of percentages so added together; provided, however, that for taxable years beginning before January first, nineteen hundred seventy-eight, if the taxpayer does not have a regular place of business outside the state other than a statutory office, the business allocation percentage shall be one hundred percent;

* * *"

New York Tax Law § 211 provides in relevant part:

"§211. Reports

"4. In the discretion of the tax commission, any taxpayer, which owns or controls either directly or indirectly substantially all the capital stock of one or more other corporations, or substantially all the capital stock of which is owned or controlled either directly or indirectly by one or more other corporations or by interests which own or control either directly or indirectly substantially all the capital stock of one or more other corporations, may be required or permitted to make a report on a combined basis covering any such other corporations and setting forth such information as the tax commission may require; * * * provided, further, that no combined report covering any corporation not a taxpayer shall be required unless the tax commission deems such a report necessary, because of inter-company transactions or some agreement, understanding, arrangement or transaction referred to in subdivision five of this section, in order properly to reflect the tax liability under this article. In the case of a combined report the tax shall be

measured by the combined entire net income or combined capital, of all the corporations included in the report. In computing combined entire net income intercorporate dividends shall be eliminated, in computing combined business and investment capital intercorporate stockholdings and intercorporate bills, notes and accounts receivable and payable and other intercorporate indebtedness shall be eliminated and in computing combined subsidiary capital intercorporate stockholdings shall be eliminated. * * *

"5. In case it shall appear to the tax commission that any agreement, understanding or arrangement exists between the taxpayer and other corporation or any person or firm, whereby the activity, business, income or capital of the taxpayer within the state is improperly or inaccurately reflected, the tax commission is authorized and empowered, in its discretion and in such manner as it may determine, to adjust items of income, deductions and capital, and to eliminate assets in computing any allocation percentage provided only that any income directly traceable thereto be also excluded from entire net income, so as equitably to determine the tax. Where (a) any taxpayer conducts its activity or business under any agreement, arrangement or understanding in such manner as either directly or indirectly to benefit its members or stockholders, or any of them, or any person or persons directly or indirectly interested in such activity or businsess, by entering into any transaction at more or less than a fair price which, but for such agreement, arrangement or understanding, might have been paid or received therefor, or (b) any taxpayer, a substantial portion of whose capital stock is owned either

directly or indirectly by another corporation, enters into any transaction with such other corporation on such terms as to create an improper loss or net income, the tax commission may include in the entire net income of the taxpayer the fair profits which, but for such agreement, arrangement or understanding, the taxpayer might have derived from such transaction."

Pub. Law 86-272, 15 U.S.C. § 381 provides:

"§381. *Imposition of net income tax*

Minimum standards

"(a) No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

"(1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and

"(2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders

resulting from such solicitation are orders described in paragraph (1).

"Domestic corporations; persons domiciled in or residents of State

"(b) The provisions of subsection (a) of this section shall not apply to the imposition of a net income tax by any State, or political subdivision thereof, with respect to—

"(1) any corporation which is incorporated under the laws of such State; or

"(2) any individual who, under the laws of such State, is domiciled in, or a resident of, such State.

"Sales or solicitation of orders for sales by independent contractors

"(c) For purposes of subsection (a) of this section, a person shall not be considered to have engaged in business activities within a State during any taxable year merely by reason of sales in such State, or the solicitation of orders for sales in such State, of tangible personal property on behalf of such person by one or more independent contractors, or by reason of the maintenance, of an office in such State by one or more independent contractors whose activities on behalf of such person in such State consist solely of making sales, or soliciting orders for sales, of tangible personal property.

Definitions

"(d) For purposes of this section—

"(1) the term 'independent contractor' means a commission agent, broker, or other independent contractor who is engaged in selling, or soliciting orders for the sale of, tangible personal property for more than one principal and who holds himself out as such in the regular course of his business activities; and

"(2) the term 'representative' does not include an independent contractor."

New Jersey Statute

54: 10A-6 of the New Jersey Statutes Annotated provides in relevant part:

"54: 10A-6. Taxpayer maintaining regular place of business outside state

"In the case of a taxpayer which maintains a regular place of business outside this State other than a statutory office, the portion of its entire net worth to be used as a measure of the tax imposed by section 5(a) of this act, and the portion of its entire net income to be used as a measure of the tax imposed by section 5(c) of this act, shall be determined by multiplying such entire net worth and entire net income, respectively, by an allocation factor which shall be the average of the fractions computed in (A), (B) and (C) below, or of so many of them as may be applicable, that is:

"(A) The average value of the taxpayer's real and tangible personal property within the State during the period covered by its report divided by the average value of all the taxpayer's real and tangible personal property wherever situated during such period; provided, however, that for the purpose of determining average value, the provisions with respect to depreciation as set forth in paragraph 2(F) of subsection (k) of section 4 of P.L. 1945, c. 162 (C. 54:10A-4) shall be taken into account for arriving at such value.

"(B) The receipts of the taxpayer, computed on the cash or accrual basis according to the method of accounting used in the computation of its net income for federal tax purposes, arising during such period from

"(1) sales of its tangible personal property located within this State at the time of the receipt of or appropriation to the orders where shipments are made to points within this State,

"(2) sales of tangible personal property located without the State at the time of the receipt of or appropriation to the orders where shipment is made to points within the State,

"(3) (Deleted by amendment.)

"(4) services performed within the State,

"(5) rentals from property situated, and royalties from the use of patents or copyrights, within the State,

"(6) all other business receipts (excluding dividends excluded from entire net income by subsection (k)(1) of section 4 hereof) earned within the State, divided by the total amount of the taxpayer's receipts, similarly computed, arising during such period from all sales of its tangible personal property, services, rentals, royalties and all other business receipts, whether within or without the State."

Regulations

The New York State Tax Commission Regulations contained in 20 NYCRR provide in relevant part:

"Section 6-2.2 Initial requirement - capital stock. (Tax Law, § 211, subd. 4) (a) In deciding whether to permit or require a group of corporations to file a combined report, the Tax Commission will first determine whether:

"(1) the taxpayer owns or controls, either directly or indirectly, substantially all of the capital stock of all the other corporations which are to be included in the combined report;

"(2) substantially all of the capital stock of the taxpayer is owned or controlled, either directly or indirectly, by other corporations which are to be included in the combined report;

"(3) substantially all of the capital stock of the taxpayer and substantially all of the capital stock of the other corporations which are to be included in the combined report are owned or controlled, either directly or indirectly, by the same interests.

"(b) the term *substantially all* means ownership or control of 80 percent or more of the voting stock. Ownership includes actual or beneficial ownership. To be considered the owner, the stockholder must have the right to vote and the right to receive dividends. The term *control* refers to all cases where the taxpayer controls the stock of all the other corporations or the stock of the taxpayer is controlled by other corporations or the taxpayer and the other corporations are controlled by the same interests. The decision as to whether or not a corporation is controlled by or controls another corporation or is controlled by the same interests will be determined by the facts in each case.

"Section 6-2.3 Other requirements—exercise of discretion. (Tax Law § 211, subds. 4 and 5) (a) After the requirement described in section 6-2.2 of this Subpart has been met, the Tax Commission may permit or require a group of corporations to file a combined report if this method of reporting properly reflects the activities in New York State of the corporations. If the income or capital of a taxpayer is improperly or inaccurately reported because of intercorporate agreements, understandings or arrangements, the Tax Commission may permit or require the corporations to file a combined report. In deciding whether to permit or require combined reports the following two broad factors must be met:

"(1) the corporations are in substance parts of a unitary business conducted by the entire group of corporations, and

"(2) there are substantial intercorporate transactions among the corporations.

"* * *

"(c) In determining whether the substantial intercorporate transaction requirement is met, the Tax Commission will consider only transactions directly connected with the business conducted by the taxpayer, such as described in paragraph (1), (2), or (3) of subdivision (b) of this section. Service functions, such as accounting, legal, and personnel will not be considered. The substantial intercorporate transaction requirement may be met where as little as 50 percent of a corporation's receipts are from any qualified activities. It is not necessary that there be substantial intercorporate transactions between any one member with every other member of the group. It is, however, essential that there be substantial intercorporate transactions among all members of the combined group."

"Section 6-2.5 Corporations not required or permitted to file a combined report. (Tax Law, § 211, subd. 4) (a) A foreign corporation not subject to tax will not be required to be included in a combined report unless the requirement described in section 6-2.2 of this Subpart has been met and the Tax Commission determines that inclusion is necessary to properly reflect the tax liability of one or more taxpayers included in the group because of:

"(1) intercorporate transactions; or

"(2) some agreement, understanding, arrangement or transaction whereby the activity, business, income or capital of any taxpayer is improperly or inaccurately reflected."

"Section 3-8.3 Alien Corporations. - (a) A corporation organized under the laws of a country other than the United States which has income from sources outside the United States * * *"